

STATE OF DELAWARE
OFFICE OF
AUDITOR OF ACCOUNTS

DEPARTMENT OF EDUCATION

DEBT SERVICE
FISCAL YEAR 2007

AGREED-UPON PROCEDURES ENGAGEMENT

FIELDWORK END DATE: SEPTEMBER 6, 2007

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Independent Accountant's Report
on Applying Agreed-Upon Procedures

The Honorable Valerie A. Woodruff
Secretary
Department of Education
Townsend Building, Suite 2
401 Federal Street
Dover, DE 19901

We have performed the procedures enumerated below, which were agreed to by the Department of Education (DOE) and the following School Districts: Appoquinimink, Brandywine, Caesar Rodney, Cape Henlopen, Capital, Christina, Colonial, Delmar, Indian River, Lake Forest, Laurel, Milford, New Castle County Vocational Technical, Polytech, Red Clay, Seaford, Smyrna, Sussex Technical, and Woodbridge. The procedures were performed solely to assist the specified parties in determining that: (a) tax receipts were properly credited by each School District as authorized by the tax levy and (b) each District's June 30, 2007 debt service balance was sufficient, without being excessive, to pay principal and interest payments for the first four months of Fiscal Year 2008. The Board of Education of each School District is responsible to levy a tax sufficient to make payment of interest and principal on outstanding bonds.

This agreed-upon procedures attestation engagement was performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States and the attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures were as follows:

1. For all School Districts, except for the four restructured School Districts within New Castle County, recalculated the real estate tax for current operations, debt service, tuition, and minor capital improvements to verify tax receipts were properly recorded in DFMS.
2. Reviewed the debt service expenditures (principal and interest) to verify they were proper and in accordance with the amortization schedule provided by the Office of State Treasurer.

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3. Compared the June 30, 2007, debt service reserve balances to the total required debt service payments for July 1, 2007 through October 31, 2007 to determine whether the debt service reserves were sufficient, without being excessive, to pay the bond principal and interest for the first four months of Fiscal Year 2008.
4. For the four restructured School Districts within New Castle County, tested DOE's September and October 2006 calculations to verify proper allocation of tax revenues.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with specified laws. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Department of Education and the School Districts identified above and should not be used by those who have not agreed to the procedures and have not taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record and its distribution is not limited. This report, as required by statute, was provided to the Office of the Governor, Office of the Controller General, Office of the Attorney General, Office of Management and Budget, Department of Finance, and the State Treasurer's Office.

R. Thomas Wagner, Jr., CFE, CGFM, CICA
Auditor of Accounts
Office of Auditor of Accounts

September 6, 2007

SCHEDULE OF FINDINGS

Procedure Agreed Upon #1

For all School Districts, except for the four restructured School Districts within New Castle County, recalculated the real estate tax for current operations, debt service, tuition, and minor capital improvements to verify tax receipts were properly recorded in DFMS.

Finding:

Indian River School District

Indian River School District improperly allocated \$109,107.25 to appropriation 8200 (Tuition) instead of appropriation 8100 (Debt Service).

Title 29 Del Code, §7514 states debt service money received " . . . shall be deposited by the State Treasurer in a special fund and shall be expended only for school construction in such district."

The error in coding was undetected by the District. A lack of reconciliation and management review contributed to the non-detection of the error. Upon notification by the Office of Auditor of Accounts (AOA), the District corrected the error.

Lake Forest School District

Lake Forest School District improperly allocated \$24,232.22 to appropriation 8100 (Debt Service) instead of 8200 (Tuition).

Title 29 Del Code, §7514 states debt service money received " . . . shall be deposited by the State Treasurer in a special fund and shall be expended only for school construction in such district."

The error in coding was undetected by the District. A lack of reconciliation and management review contributed to the non-detection of the error. Upon notification by the Office of Auditor of Accounts, the District corrected the error.

Appoquinimink School District

Appoquinimink School District improperly allocated \$2,345.91 to appropriation 8300 (Cafeteria Account) instead of appropriation 8400 (Minor Cap). The District also improperly allocated the November tax receipts across appropriations 8000, 8100, 8200, and 8400. A Cash Adjustment Document (CA) totaling \$22,345.30 was processed to transfer the funds into the correct appropriations.

Title 29 Del Code, §7514 states debt service money received " . . . shall be deposited by the State Treasurer in a special fund and shall be expended only for school construction in such district."

The errors in coding were undetected by the District. A lack of reconciliation and management review contributed to the non-detection of the errors. Upon notification by the Office of Auditor of Accounts, the District corrected the errors.

SCHEDULE OF FINDINGS

Recommendation

Indian River School District

The District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Lake Forest School District

The District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Appoquinimink School District

Appoquinimink School District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Auditee Response

Indian River School District

The Indian River School District will adhere with the policies and procedures promulgated within the statutory regulations, policy manuals and procedural manuals; however, it should be further noted that the error detection was identified via examination of EXCEL spreadsheet formulas and not by the Office of the Auditor of Accounts. In actuality, the residual discrepancies with the DFMS Reports are considered immaterial and not warranting additional resources of the Office of the Auditor of Accounts to further identify. Additionally, it is completely inaccurate and an outright falsification to specify that the Indian River School District does not perform reconciliations and review procedures as mentioned by the Office of the Auditor of Accounts.

Auditor Comment

AOA discovered the \$109,107.25 variance while performing Agreed Upon Procedure #1 and notified the District of the variance. The District researched the discrepancy and discovered a formula error in its allocation spreadsheet. Had the District been performing reconciliation and review procedures as claimed above, the error would have been detected and corrected within the first few months of the fiscal year. AOA reaffirms the recommendation as stated above.

Lake Forest School District

Lake Forest School District will implement a reconciliation and review process to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Appoquinimink School District

The Appoquinimink School District reconciled the FY2007 local tax collections, noted the differences, and generated correcting documentation (1) CA #2900000020 to correct CR#95-582397 in the amount of \$22,345.30, and (2) CA #29000000018 correcting CR #95-95-570125 in the amount of \$2,345.91. The District has established a monthly reconciliation and review process utilizing the AOA spreadsheet and internal revenue reporting documentation to correctly identify all transactions and appropriately report collected revenues in a timely manner.

SCHEDULE OF FINDINGS

Procedure Agreed Upon #2

Review the debt service expenditures (principal and interest) to verify they were proper and in accordance with the amortization schedule provided by the Office of the State Treasurer.

Finding:

Indian River School District

Indian River School District improperly allocated \$2,374.31 of audit fees to appropriation 8100 Debt Service, which is not in accordance with Delaware Code. The District allocated local fund audit costs across various local fund appropriations based on their June 30, 2006 unencumbered balances.

Delaware Code permits debt service funds to be expended only for bond principal and interest payments. Title 14 Del. C., Sections 2116 and 2118 (e) state, "The authority to issue bonds shall be construed to be authority to provide funds for the payment of the interest and annual payments on such bonds . . ." and, "The Secretary of Finance is hereby authorized and directed to draw warrants or drafts on such fund in the amount of the principal of and interest on such bonds or other obligations as the same shall become due and payable . . ."

Recommendation:

Indian River School District

The District should process a correction document for \$2,374.31 to refund the Debt Service appropriation and ensure that only bond principal and interest payments are paid with these funds.

Auditee Response

Indian River School District

The Indian River School District believes that the inconsistent application of procedures and interpretations of the procedures via the various auditors have promulgated with inconsistent application of applicable statutory regulations. During every fiscal period, the Office of the Auditor of Accounts has performed debt service audits for the District and every fiscal period the District has been the prorating of local audit fees to debt service appropriation.

Either the previous evaluation periods were inaccurate and/or incomplete or a different interpretation was fostered. In either case, it is inappropriate for the promotion of inconsistent application of statutory regulations by watchdog entities.

Auditor Comment

AOA researched the above comment that the District has previously prorated the local audit fees to the debt service appropriation by reviewing the debt service audit work papers for Fiscal Years 2006, 2005, and 2004. There was no evidence of the allocation of audit fees to the debt service appropriation during these fiscal years; therefore, AOA has consistently applied the procedures from year to year. AOA reaffirms the recommendation as stated above.

SCHEDULE OF FINDINGS

Procedure Agreed Upon #3

Compared the June 30, 2007, debt service reserve balances to the total required debt service payments for July 1, 2007 through October 31, 2007 to determine whether the debt service reserves were sufficient, without being excessive, to pay the bond principal and interest for the first four months of Fiscal Year 2008.

Finding:

Delmar School District

Delmar School District's debt service balance as of June 30, 2007 was \$805,042. Principal and interest payments for the period of July 1, 2007 through October 31, 2007 total \$101,194. Principal and interest payments for Fiscal Years 2008 and 2009 (July 1, 2007 through June 30, 2009) total \$388,229 and \$377,101, respectively. The balance as of June 30, 2007 is excessive, as it provides for 100 percent of principal and interest payments for Fiscal Years 2008 and 2009. Although the School Board has reduced the debt service tax rate from 0.85 to 0.65 for Fiscal Year 2008, projections provided by the District indicate an excessive balance through Fiscal Year 2012.

Attorney General's Opinion 1W-024 dated July 15, 1975 states, "The power of a district to levy taxes for bonded indebtedness is limited to the amount necessary to pay the interest and annual payment on outstanding bonds, plus 10 percent for delinquencies (14 Del. C., Section 2116, 2118)." Additionally, this opinion affirms that, "A school district may not assess debt service taxes in an amount which exceed that necessary to pay off its bond obligations as they fall due." The Department of Education recommends a 4-month reserve be maintained to provide adequate cash flow.

Insufficient reductions in the debt service tax rate result in noncompliance with Attorney General's Opinion 1W-024 and unnecessary tax collections from taxpayers within the District.

Recommendation

Delmar School District

Delmar School District should substantially reduce its debt service reserve by reducing its debt service tax rate. The District monitor the debt service obligations, tax rate, and projected tax base to ensure adequate, but not excessive, funds to meet debt service obligations.

Auditee Response

Delmar School District

On Wednesday, September 26, 2007 members of Delmar School District, Department of Education, and the Office of Auditor of Accounts met to address the concerns expressed in the review of the District's debt service transactions and account balances for the period July 1, 2006 through June 30, 2007. The following information was provided:

- a. The school superintendent addressed the community with several scheduled meetings both at the district and the Delmar Fire Hall in relation to the referendum.

SCHEDULE OF FINDINGS

- b. A referendum was held on April 25, 2007, which stated the following, "*Delmar School District of Sussex County, in the State of Delaware, pursuant to the Delmar Board of Education approval given March 6, 2007, in accordance with the provisions of Title 14, Chapter 19 of the Delaware Code as amended, in order to permit the voters of said district to vote **for** or **against** the transfer of fifteen cents [\$0.15] per hundred dollars [\$100.00] of assessed valuation of property from the debt service tax fund to current operating expenses for the specific purposes of materials, supplies, and other academic programs.*" The referendum passed and the citizens agreed to the request.
- c. Debt Service Summary Disbursements VS Available Funds Chart was reviewed.
- d. The Delmar Board of Education and the Superintendent will watch the financial projections for FY08 and will review the Debt Service account, and will make every effort to continue to reduce the account.

SCHEDULE OF PRIOR YEAR FINDINGS

The following schedule summarizes prior year findings and the status of the prior year findings:

Prior Year Finding	Recommendation	Status of Prior Year Finding
Appoquinimink School District improperly allocated \$16,401.42 to appropriation 8300 instead of appropriation 8400.	Implement reconciliation and review process to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.	<u>Not implemented</u> - A variance was noted by AOA and a cash adjustment was required.
Laurel School District-A data entry error by the State of Delaware Treasurer's Office resulted in the improper allocation of \$43,857.93 to appropriation 8000 instead of 8100.	The Treasurer's Office and the District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.	<u>Implemented</u> - Tax receipts were properly recorded in DFMS in FY07.
Brandywine and Red Clay School District-The State of Delaware Treasurer's Office incorrectly recorded Brandywine School District's July 2006 principal payments for bond numbers 185 and 189.	The Treasurer's Office and the District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.	<u>Implemented</u> - Principal and interest payment were properly recorded in DFMS in FY07.
Caesar Rodney School District-Debt service 6/30/06 balance was excessive in relationship to July through October 2006 required debt service payments.	The District should reduce its debt service reserve by reducing its debt service tax rate. Monitor the debt service obligations, tax rate, and projected tax base to ensure adequate, not excessive, funds to meet the debt service obligations.	<u>Partially Implemented</u> - The debt service tax rate was lowered; however, the reserve balance is still excessive because of the district plans for issuing new bonds in FY08.
Christina School District-Debt service 6/30/06 balance was not sufficient to make July through October 2006 required debt service payments.	Establish a sufficient debt service tax rate (based upon projected debt service balances, tax base, and expenditures) to meet principal and interest obligations.	<u>Implemented</u> - The debt service tax rate was sufficient without being excessive. The rate was lowered for FY08 to reduce the reserve slightly.

SCHEDULE OF PRIOR YEAR FINDINGS

Prior Year Finding	Recommendation	Status of Prior Year Finding
Delmar School District-Debt service reserve balance was excessive. The balance could have paid 100% interest and principal for the next two fiscal years.	Delmar School District substantially should reduce its debt service reserve by reducing its debt service tax rate. Monitor the debt service obligations, tax rate, and projected tax base to ensure adequate, not excessive, funds to meet debt service obligations.	<u>Partially Implemented</u> - The district decreased the debt service tax rate for FY07. However, the reduction was only sufficient to lower the reserve for a few years. According to the district's projections, the reserve will begin increasing again in FY11.
Indian River School District-Debt service 6/30/06 balance was not sufficient to make July through October 2006 required debt service payments. The district increased the debt service tax rate for FY07. However, review of detailed calculations revealed incomplete and incorrect info.	Ensure current, complete information is considered in calculating the debt service tax rate for future tax years, in order to accumulate an ending balance sufficient to pay the first four months debt service payments of the subsequent fiscal year.	<u>Implemented</u> - The district increased the debt service tax rate for FY08 and, per review of detailed calculations, all bond amortization schedules were considered in the projection.

Status Key:
Implemented

The concern has been addressed by implementing the original or an alternate corrective action.

Not Implemented

The corrective action has not been initiated.

Partially Implemented

The corrective action has been initiated but is not complete and the auditor has reason to believe management fully intends to address the concern.

DISTRIBUTION OF REPORT

Copies of this report have been distributed to the following public officials:

Executive Branch

The Honorable Ruth Ann Minner, Governor, State of Delaware
The Honorable Richard S. Cordrey, Secretary, Department of Finance
The Honorable Jennifer W. Davis, Director, Office of Management and Budget
Ms. Trisha Neely, Director, Division of Accounting, Department of Finance

Legislative Branch

The Honorable Russell T. Larson, Controller General, Office of Controller General

Other Elective Offices

The Honorable Joseph Biden Jr., Attorney General, Office of the Attorney General
The Honorable Jack Markell, Treasurer, State Treasurer's Office

Other

Ms. Dorcell S. Spence, Associate Secretary of Education, Finance and Administrative Services,
Department of Education
Mr. Jerry Gallagher, Director, Financial Management, Department of Education
Superintendents, All School Districts